

Internal Revenue Service

Number: **201103018**

Release Date: 1/21/2011

Index Number: 707.01-00

Department of the Treasury

Washington, DC 20224

Third Party Communication: None

Date of Communication: Not Applicable

Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

CC:PSI:B03

PLR-120301-10

Date:

September 23, 2010

Legend

Taxpayer =

LLC =

State1 =

State2 =

Lenders =

Fund1 =

Fund2 =

LP =

Debt1 =

Debt2 =

Debt3 =

a =

b =

Dear _____ :

We received your letter dated May 10, 2010, and subsequent correspondence, submitted on behalf of Taxpayer requesting a ruling under § 707(a)(2)(B) of the Internal Revenue Code (Code). This letter responds to that request.

Facts

Taxpayer is a State1 real estate investment trust that holds and operates multiple residential properties, either directly or indirectly through disregarded entities or partnerships, including LLC. Taxpayer was formed on a, and is treated as a partnership for federal tax purposes. Taxpayer's majority owners are partnerships that tier up through other entities, including LP, to Fund1 and Fund2, which are owned by several investors.

LLC is a State2 limited liability company that was formed on b. Taxpayer currently owns a majority interest in LLC, which is treated as a partnership for federal tax purposes. LLC directly and indirectly owns interests in several properties.

Currently, Taxpayer's liabilities exceed the value of its assets. To improve its debt structure, Taxpayer and the Lenders have agreed to restructure Taxpayer and convert part of Taxpayer's debt to the Lenders into indirect equity interests of the Lenders in Taxpayer.

As part of the proposed restructuring, the Lenders will transfer certain debt they hold, including Debt1, Debt2, and Debt3 ("Debt"), to LP, a partnership for federal tax purposes, in exchange for an interest in LP. As a result of this transfer to a party related to Taxpayer, Taxpayer will recognize cancellation of indebtedness ("COD") income. In addition, Taxpayer will transfer all of its assets and most of its liabilities, including the Debt, to LLC in exchange for an increased interest in LLC. Then, LP will transfer the Debt it holds to LLC in exchange for an interest in LLC. As a result of this transfer of the Debt by LP to LLC, the Debt will be discharged in the hands of LLC. LLC will recognize COD income from the discharged Debt, all of which will be allocated to Taxpayer.

Taxpayer has requested a ruling that the transfer of its assets and liabilities, including the Debt, to LLC in connection with the transfer of the Debt held by LP to LLC will not constitute a disguised sale of property by Taxpayer to LLC under § 707(a)(2)(B). Relative to its proposed restructuring, Taxpayer has made the following representations:

1. Taxpayer will recognize COD income under § 108(e)(4) (except to the extent that § 1.108-2(e)(1) of the Income Tax Regulations applies) as a result of the transfer

- of the Debt to LP, a party related to Taxpayer, equal to the excess of the adjusted issue price of the Debt over its fair market value;
2. All of Taxpayer's liabilities transferred to LLC, except the Debt, constitute qualified liabilities under § 1.707-5(a)(6);
 3. The Debt transferred by Taxpayer to LLC would constitute qualified liabilities under § 1.707-5(a)(6) except for the fact that the amount of the Debt exceeds the fair market value of the transferred property (less the amount of other liabilities that are senior in priority and encumber such property at the time of the transfer) at the moment of the transfer prior to the discharge of the Debt;
 4. LLC will recognize COD income under § 108(e)(8) as a result of the transfer of the Debt held by LP to LLC in exchange for an interest in LLC equal to the excess of the issue price of the Debt (taking into account the § 108(e)(4) transaction described in the first representation above) over the fair market value of the interest in LLC;
 5. The preceding COD income that will be recognized by LLC is properly allocable to Taxpayer under § 704(b); and
 6. There will be no actual transfers of money or other property from LLC to Taxpayer that would not have been made but for the transfer of Taxpayer's assets to LLC. In addition, LLC will not make any distributions of cash or property to Taxpayer that would be presumed to be part of a disguised sale under § 707(a)(2)(B) and the regulations thereunder.

Law and Analysis

Section 707(a)(2)(B) provides that if (i) there is a direct or indirect transfer of money or other property by a partner to a partnership, (ii) there is a related direct or indirect transfer of money or other property by the partnership to such partner (or another partner), and (iii) the transfers described in § 707(a)(2)(B)(i) and (ii), when viewed together, are properly characterized as a sale or exchange of property, such transfers shall be treated as a transaction occurring between the partnership and one who is not a partner, or as a transaction between two or more partners acting other than in their capacity as members of the partnership.

Section 1.707-3(a)(1) provides that, except as otherwise provided, if a transfer of property to a partnership and one or more transfers of money or other consideration by the partnership to that partner are described in § 1.707-3(b)(1), the transfers are treated as a sale of the property, in whole or in part, to the partnership.

Section 1.707-3(b)(1) provides that a transfer of property (excluding money or an obligation to contribute money) by a partner to a partnership and a transfer of money or other consideration (including the assumption of or the taking subject to a liability) by the partnership to the partner constitute a sale of property, in whole or in part, by the partner to the partnership only if, based on the facts and circumstances (i) the transfer of money or other consideration would not have been made but for the transfer of

property, and (ii) in cases in which the transfers are not made simultaneously, the subsequent transfer is not dependent on the entrepreneurial risks of the partnership operations.

Section 1.707-3(c)(1) provides that, if within a two-year period a partner transfers property to a partnership and the partnership transfers money or other consideration to the partner (without regard to the order of the transfers), the transfers are presumed to be a sale of the property to the partnership unless the facts and circumstances clearly establish that the transfers do not constitute a sale.

Section 1.707-5(a) states that for purposes of §§ 1.707-3, 1.707-4, and 1.707-5, if a partnership assumes or takes property subject to a qualified liability (as defined in § 1.707-5(a)(6)) of a partner, the partnership is treated as transferring consideration to the partner only to the extent that the transfer of property to the partnership is otherwise treated as part of a sale. By contrast, if the partnership assumes or takes property subject to a liability of the partner other than a qualified liability, the partnership is treated as transferring consideration to the partner to the extent that the amount of the liability exceeds the partner's share of the liability immediately after the partnership assumes or takes subject to the liability as provided in §§ 1.707-5(a)(2), (3), and (4).

Section 1.707-5(a)(6) provides that a liability assumed or taken subject to by a partnership in connection with a transfer of property to the partnership by a partner is a qualified liability of the partner to the extent—(i) The liability is—(A) A liability that was incurred by the partner more than two years prior to the earlier of the date the partner agrees in writing to transfer the property or the date the partner transfers the property to the partnership and that has encumbered the transferred property throughout that two-year period; (B) A liability that was not incurred in anticipation of the transfer of the property to a partnership, but was incurred by the partner within the two-year period prior to the earlier of the date the partner agrees in writing to transfer the property or the date the partner transfers the property to the partnership and that has encumbered the transferred property since it was incurred; (C) A liability that is allocable under the rules of §1.163-8T to capital expenditures with respect to the property; or (D) A liability that was incurred in the ordinary course of the trade or business in which the property transferred to the partnership was used or held but only if all the assets related to that trade or business are transferred other than the assets that are not material to a continuation of the trade or business; and (ii) If the liability is a recourse liability, the amount of the liability does not exceed the fair market value of the transferred property (less the amount of any liabilities that are senior in priority and that either encumber such property or are liabilities described in § 1.707-5(a)(6)(i)(C) or (D)) at the time of the transfer.

Section 1.707-5(a)(2)(i) provides that a partner's share of a recourse liability of the partnership equals the partner's share of the liability under the rules of § 752 and the regulations thereunder. A partnership liability is a recourse liability to the extent the

obligation is a recourse liability under § 1.752-1(a)(1) or would be treated as a recourse liability under § 1.752-1(a)(1) if it were treated as a partnership liability for purposes of that section.

Section 1.707-5(a)(2)(ii) provides that a partner's share of a nonrecourse liability of the partnership is determined by applying the same percentage used to determine the partner's share of the excess nonrecourse liability under § 1.752-3(a)(3). A partnership liability is a nonrecourse liability of the partnership to the extent the obligation is a nonrecourse liability under § 1.752-1(a)(2) or would be a nonrecourse liability under § 1.752-1(a)(2) if it were treated as a partnership liability for purposes of that section.

Under Taxpayer's proposed restructuring, part of the liabilities Taxpayer will transfer to LLC, the Debt, will exceed the fair market value of the assets Taxpayer will transfer to LLC. Under § 1.707-5(a)(6)(ii), a liability is not considered a qualified liability to the extent that the amount of the liability exceeds the fair market value of the assets transferred. Accordingly, for purposes of § 1.707-5(a)(6), the Debt should be bifurcated into two liabilities: the portion of the Debt that equals the net fair market value of the assets Taxpayer will transfer to LLC, which Taxpayer represents will constitute qualified liabilities, and the remaining portion of the Debt, which will exceed the value of the assets transferred ("Excess Debt"). According to Taxpayer, the Excess Debt will be allocated to Taxpayer under § 752 following the transfer of Taxpayer's liabilities to LLC. Moreover, the Excess Debt will exceed the fair market value of the assets transferred by Taxpayer only momentarily following the transfer, after which the Debt will be discharged (when LP transfers the Debt it holds to LLC in exchange for an interest in LLC). Finally, all COD income resulting from the transfers of the Debt will be recognized by Taxpayer.

Conclusion

Based on the facts submitted and representations made, we conclude that Taxpayer's proposed transfer of assets and liabilities, including the Debt, to LLC in connection with the transfer of the Debt held by LP to LLC will not constitute a disguised sale of property by Taxpayer to LLC under § 707(a)(2)(B).

Except as expressly provided herein, we express or imply no opinion concerning the federal tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Under a power of attorney on file with this office, we are sending a copy of this letter to Taxpayer's authorized representatives.

Sincerely,

/s/

Mary Beth Carchia
Senior Technician Reviewer, Branch 3
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures (2)

A copy of this letter

A copy for § 6110 purposes